WORLD TRADE INFORMATION SERVICE

ECONOMIC REPORTS

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income taxation in the United Kingdom

THE Income Tax Act (chap. 10) of 1952 consolidated the provisions contained in the Income Tax Act, 1918, and some 50 subsequent acts. This consolidation, together with the income tax sections found in the Finance Acts of 1952, 1953, 1954, and 1955, constitute the existing statutory provisions under which income tax is imposed on individuals, partnerships, companies, and other taxpayers.

Personal Income Taxation

The United Kingdom income tax is chargeable on the total income received from all sources by individuals resident in the United Kingdom and, with some exceptions, on income received by individuals not resident in the United Kingdom which has been derived from sources in the United Kingdom. However this latter principle is substantially modified in the case of United States residents by the exemptions granted by the United States-United Kingdom Income Tax Convention to which further reference is made in this report.

Allowances

Taxable income is ordinarily computed by subtracting from gross income an amount equal to two-ninths of earned income (i.e., income from a profession, employment, or pension as differentiated from income from investments, rents, royalties, etc.) up to a maximum allowance of £450.

In addition there are personal allowances of £140 for single persons; £240 for husband and wife; £100 for each child; and £50 for each other dependent relative. Special provision is also made for increasing the married allowance where the return includes the wife's earnings, for persons over 65, and for certain categories of dependents not related to the taxpayer.

As a result of these allowances, the exemption limits for earned incomes are as follows: Single person, £180; married, £309; married with one child, £437; and married with two children, £566.

Standard Income Tax Rate

Since the year of assessment beginning on April 6, 1955, the first £60 of taxable income has been subject to tax at the rate of 2 shillings (s) 3 pence (d) in the pound (11.25 percent); the next £150 at 4s. 9d. in the pound (23.75 percent); the next £150, at 6s. 9d. (33.75 percent); and the remainder, at the standard rate of 8s. 6d. in the pound (42.5 percent).

Surtax Rates

The surtax applies to individuals only and is not levied on companies. Income which has been subject to deduction of the standard rate of tax at source (dividends, interest, patent royalties, etc.) is included with other income for surtax purposes. The surtax is always assessed direct against the individual recipient of the income. The taxpayer is not required to make a separate return as the assessments are usually made from the return submitted by the taxpayer for standard income tax purposes.

The surtax applies to that part of the total income (without deduction of personal allowances and earned income exemption granted for the standard tax) in excess of £2,000. Surtax payments are in effect deferred tax assessments, as for example, surtax assessed for the year 1953-54 was payable on January 1, 1955, instead of January 1, 1954, as is the case with the standard income tax.

The surtax rates are as follows, in percent:

	Percent		*Percent*
First £2,000	0.0	Next:	
Next:			
£ 500	10.0	£2,000	32.5
500	12.5	2,000	37.5
1,000	17.5	2,000	42.5
1,000	22.5	3,000	47.5
1,000	27.5	Remainder	50.0

Taxes on Specimen Incomes

The amounts of income tax and surtax, if any, for specimen incomes where the income is either all "earned" or all "investment" in origin are shown in the following table.

UNITED STATES DEPARTMENT OF COMMERCE • Sinclair Weeks, Secretary
BUREAU OF FOREIGN COMMERCE • Loring K. Macy, Director

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Income Tax (and Surtax, if Any) on Earned and Investment Income

[In pounds (£) and shillings (s)]

Income (pounds)	Single person £	Single person s.	Married couple without children £	Married couple without children s.	Married couple with one child £	Married couple with one child s.	Married couple with two children £	Married couple with two children s.
	Earned income[1]							
200	1	15	..	..	..	..	..	..
300	14	13	..	..	..	..	..	..
400	33	8	9	9	..	..	..	..
500	55	10	27	17	5	10	..	..
600	81	15	48	0	22	12	8	0
1,000	211	1	168	11	126	1	85	10
1,500	376	7	333	17	291	7	248	17
2,000	541	12	499	2	456	12	414	2
2,500	801	15	759	5	716	15	674	5
5,000	2,826	15	2,284	5	2,241	15	2,199	5
10,000	6,126	15	6,084	5	6,041	15	5,999	5
20,000	15,151	15	15,109	5	15,066	15	15,024	5
50,000	42,901	15	42,859	5	42,816	15	42,774	5
100,000	89,151	15	89,109	5	89,066	15	89,024	5
	Investment income[1]							
200	1	15	..	..	..	..	..	..
300	14	18	..	..	..	..	..	..
400	59	5	30	10	6	15	..	..
500	93	0	59	5	30	10	6	15
600	135	10	93	0	59	5	30	10
700	178	0	135	10	93	0	59	5
1,000	305	10	263	0	220	10	178	0
5,000	2,518	0	2,475	10	2,433	0	2,390	10
10,000	6,318	0	6,275	10	6,233	0	6,190	10
100,000	89,343	0	89,300	10	89,258	0	89,215	10

[1] All incomes below £300 a year receive the earned income exemption, with a marginal exemption where the income slightly exceeds £300. Where the taxpayer (or his wife if they are living together) is over age 65 at any time in the tax year, and his total income does not exceed £600, age relief is given; this reduces the tax payable to that chargeable on the earned income scale. Where the total income exceeds £600, marginal relief is given so that the full tax on the investment scale is not payable until the marginal relief runs out.

Note: £1 equals $2.80, U. S. currency; 1s. equals $0.14.

The method of calculating the income tax and surtax payable by a married man, with two children, earning £5,000 per annum is as follows:

Income	£5,000
Less earned income exemption (maximum)	450
Remainder	4,550
Less personal exemptions: As married man, £240; two children, £200	440
Taxable income	4,110

The income tax on £4,110 taxable income is calculated as follows:

	£	s.	d.
£60 at 2s. 3d. (11.25 percent)	6	15	0
£150 at 4s. 9d. (23.75 percent)	35	12	6
£150 at 6s. 9d. (33.75 percent)	50	12	6
£3,750 at 8s. 6d. (42.5 percent)	1,593	15	0
Income tax	1,686	15	

In addition, the amount subject to surtax is calculated as follows:

Total income	£5,000
Less surtax exemption	2,000
Subject to surtax	3,000

The surtax on £3,000 is calculated as follows:

	£	s.
£500 at 2s. (10 percent)	50	0
£500 at 2s. 6d. (12½ percent)	62	10
£1,000 at 3s. 6d. (17½ percent)	175	0
£1,000 at 4s 6d. (22½ percent)	225	0
Surtax	512	10

Thus, a married man, with two children, earning £5,000 a year pays an income tax of £1,686 15s. plus a surtax of £512 10s., or a total tax of £2,199 5s.

The calculations for investment incomes are made similarly, except that no earned income exemption may be taken unless age relief is applicable, or the total income is less than £300.

Capital Gains

The United Kingdom has no capital gains tax. However, capital profits may be assessable for income tax and surtax if, for example, it is part of the business to deal or trade in securities, or if there are exceptional circumstances.

Taxes on Corporate Income

The taxable profits of a company (an incorporated business) operating in the United Kingdom are subject to income tax at the standard rate, and to a profits tax on distributed and undistributed earnings. An excess profits levy on companies which had been in effect from January 1, 1952, was abolished as of January 1, 1954.

Income Tax

After a company (an incorporated business) operating in the United Kingdom is taxed at the standard rate on its total taxable profits, no further tax at the standard rate is payable to the British Government by either the shareholders or the company on a distribution of such profits, but, on payment, the company is entitled to deduct the appropriate tax from the dividends.

The tax "appropriate" to a dividend payment is the standard rate of tax for the year in which the dividend was declared, regardless of the rate at which the amount distributed was actually taxed when the company was assessed on its profits. The company thus more or less recoups itself by deducting the standard rate of tax, which it retains, so that the company may be considered as ultimately bearing the tax only on its undistributed income.

The shareholder receiving the dividend is regarded in the British income tax regulations as having paid by deduction the tax appropriate to the dividend. However, where the company declares no dividend, the shareholders have no direct concern in the payment by the company of the tax on its profits.

The standard rate of income tax since April 6, 1955, has been 8s. 6d. in the pound or 42.5 percent.

Profits Tax

The profits tax was originally known as the National Defence Contribution, which was introduced by the Finance Act of 1937. Its present title derives from the Finance Act, 1946. The principles of this tax are therefore established by the act of 1937 as modified by subsequent finance acts.

The profits tax, from which individuals and partnerships are exempt, is levied on companies at the rate of 22.5 percent on distributed profits, but undistributed profits are granted a relief of 20 percent so that profits added to reserves or otherwise reinvested in the business bear a rate of only 2.5 percent. The taxable profits, subject to minor adjustments, are determined on the same principles as profits arising from a trade or business are computed for income tax purposes. The profits tax is not an allowable deduction for computing profits for income tax calculations.

Where a trade or business is carried on by a company ordinarily resident in the United Kingdom and a nonresident company (e.g., parent company in the United States) controls directly or indirectly not less than one-half of the voting power in the United Kingdom company, distributions made to the nonresident company are left out of account in arriving at the net distribution subject to tax. Consequently, dividends distributed to a controlling company resident in the United States would be chargeable profits of the British subsidiary at the 2.5 percent rate, and not at 22.5 percent. Therefore, in the case of a British subsidiary wholly owned by a U. S. parent company, its total tax rate on profits would be 45 percent, i.e., 42.5 percent standard income tax and 2.5 percent profits tax.

Relief is granted to small business enterprises by exempting from tax those whose profits do not exceed £2,000, and if the profits exceed £2,000 but are less than £12,000, the amount on which the tax is payable is reduced by a sum equal to one-fifth of the difference between the amount of those profits and £12,000.

Initial Depreciation Allowances

To encourage the reequipment and modernization of British industry in the postwar years a system of initial allowances for capital expenditures on plant and machinery, on the construction of industrial buildings, and on mining works was first introduced in 1945, but it was suspended as of April 6, 1952.

A year later initial allowances were reinstated for expenditures made after April 14, 1953. These initial allowances applied on the same basis to the profits tax and the income tax and could be taken in the year in which the investment was made. The rate for plant and machinery was fixed at 20 percent and that for capital expenditures on the construction of industrial buildings at 10 percent. The rate of initial allowance for capital expenditures, both at home and overseas, on new mining works (a term that includes such things as pit shafts and oilwells but not plant and machinery) was set at 40 percent instead of the 10 percent granted in the 1945-52 period.

These initial allowances in effect result in accelerated depreciation writeoffs or, from another viewpoint, are essentially similar to interest-free loans. For example, in the case of an industrial building with a 50-year life for tax purposes, 10 percent of the cost may be written off in the first year, and then 2 percent each year for the next 45 years. The initial allowance merely anticipates a part of the annual allowances so that the tax liability is less in the year in which investment takes place, but may be larger later on.

Investment Allowances

In his budget speech of April 6, 1954, the Chancellor of the Exchequer stated: "I have tried to devise some fresh encouragement to put money into productive investment. This is the more essential since the physical and financial resources at our disposal are now sufficient to allow a substantially higher rate of investment than we are undertaking. . . . After considerable reflection, therefore, I have decided to take a further step, and replace, subject to a few exceptions, the present initial allowances by a new system which I call investment allowances" (Hansard, April 6, 1954, col. 224).

The investment allowance gives a tax-free allowance equal to a part of the cost of investment made after April 6, 1954, in assets qualifying for it, and applies for the purposes of both the profits tax and the income tax. It is given in addition to the full annual depreciation allowances. The rates of investment allowance are 20 percent for expenditure on new plant and machinery, scientific research, and mining works and 10 percent for new industrial and agricultural buildings. For example, 20 percent of the cost of new machinery may be deducted in the first year, and then the normal depreciation allowance may also be taken (i.e., 100 percent spread over the life of the machinery) so that eventually 120 percent of the cost will have been allowed in deductions.

Expenditures on agricultural buildings and on plants and buildings used for scientific research were not eligible for initial allowances, but they are eligible for the investment allowance. On the other hand, this tax-free benefit is not available either for second-hand plant and machinery which does not represent new investment or for ordinary motorcars which can and often do serve both business and private purposes, but these assets will continue to rank for the initial allowance at 20 percent.

The 20-percent investment allowance for mining works is not immediately as favorable as the initial allowance of 40 percent, but since the investment allowance is given over and above depreciation up to the cost of the works, it will almost always be better in the long run. The mining undertaking is allowed an option to take either the new investment allowance at 20 percent or the initial allowance at the 40-percent rate.

Total Taxes on Company Profits

The total taxes payable on company profits will vary according to the proportion of profits distributed, with the effective combined rate ranging from a minimum of 45 percent to a maximum of approximately 59.2 percent. The following examples illustrate the application of the income tax and the profits tax, and show effective combined rates under certain assumptions:

Taxable profits 100, with no distribution:

Income tax (42.5 percent)	42.5	
Undistributed profits tax (2.5 percent)	2.5	
Total tax payable	45.0	45.0
Profits retained in business		55.0
		100.00

Taxable profits 100, with total distribution:

Income tax (42.5 percent)	42.5	
Undistributed profits tax (2.5 percent)	2.5	
Distributed profits tax (20 percent of gross dividend of 71)	14.2	
Total taxes payable	59.2	59.2
Net dividend (71 gross dividend less income tax at 42.5 percent)		40.8
		100.00

Taxable profits 100, with 50 retained in the business:

Income tax (42.5 percent)	42.5	
Undistributed profits tax (2.5 percent)	2.5	
Retained in the business		50.0
Distributed profits tax (20 percent of gross dividend of 6.45)	1.29	
Total taxes payable	46.29	46.29
Net dividend		3.71
		100.00

Taxable profits 100, with 25 retained in the business:

Income tax (42.5 percent)	42.5	
Undistributed profits tax (2.5 percent)	2.5	
Retained in the business		25.0
Distributed profits tax (20 percent of gross dividend of 38.71)	7.74	
Total taxes payable	52.74	52.74
Net dividend		22.26
		100.00

U. S.-U. K. Income Tax Convention

A convention between the United States and the United Kingdom with respect to income taxation was signed in Washington on April 16, 1945, and ratifications were exchanged on July 25, 1946. The convention took effect as respects the U. K. income tax for the year of assessment beginning on April 6, 1945, and for the surtax year of assessment beginning April 6, 1944. The full text of the convention, issued under the Treaties and Other International Acts Series 1546 as Department of State Publication 2650, is for sale by the Superintendent of Documents, U. S. Government Printing Office, Washington 25, D. C., at 10 cents a copy.

The following among the provisions of this convention are of general interest to persons resident in the United States and to U. S. corporations.

Dividends

The United Kingdom does not impose its standard income tax upon dividends (this tax is levied only once on company profits and distributions) but does impose a surtax upon such dividends if the overall income exceeds £2,000. Paragraph 2 of article VI exempts, from the U. K. surtax, dividends derived from U. K. sources by a resident of the United States who is subject to U. S. tax with respect to such dividends, and is not engaged in trade or business in the United Kingdom.

Interest

Paragraph 2 of article VII exempts, from the U. K. tax, interest (on bonds, securities, notes, debentures, or any other form of indebtedness) derived from sources within the United Kingdom by a resident of the United States who is subject to U. S. tax on such interest and is not engaged in trade or business in the United Kingdom. However, such exemption does not apply to such interest paid by a subsidiary corporation in the United Kingdom to a parent U. S. corporation controlling, directly or indirectly, more than 50 percent of the entire voting power in the paying corporation.

Royalties

A resident of the United States who is not engaged in trade or business in the United Kingdom and who is subject to U. S. tax on royalties and other amounts paid as consideration for the use of, or for the privilege of using, copyrights, patents, designs, secret processes and formulae, trademarks, and other like property is, according to paragraph 2 of article VIII, exempt from U. K. tax on such royalties or other amounts. For the purposes of this article, the term "royalties" is also deemed to include rentals in respect of motion picture films.

Compensation for Personal Services

Paragraph 2 of article X provides that any individual who is a resident of the United States shall be exempt from the U. K. tax upon profits, emoluments, or other remuneration in respect of personal (including professional) services performed within the United Kingdom in any year of assessment if (a) he is present within the United Kingdom for a period or periods not exceeding in the aggregate 183 days during that year, and

NOTE: The Chancellor of the Exchequer announced on October 26 that the Profits Tax rate was being advanced by 5 percent to 27.5 percent. This will raise the effective combined rate of income tax and profits tax to a maximum of about [illegible]-2/3 percent.

(b) such services are performed for or on behalf of an employer resident in the United States. No limitation is placed on the amount of compensation for such services.

The provisions of this article do not apply to the compensation, profits, emoluments, or other remuneration of public entertainers such as stage, motion picture or radio artists, musicians, and athletes. Unless the conditions of (a) and (b) above are satisfied, the earnings of a resident of the United States working in the United Kingdom are subject to the U. K. tax, but, if such income is also subject to U. S. tax, credit may be taken for the tax paid in the United Kingdom (see section 131, U. S. Internal Revenue Code).

September 1955.

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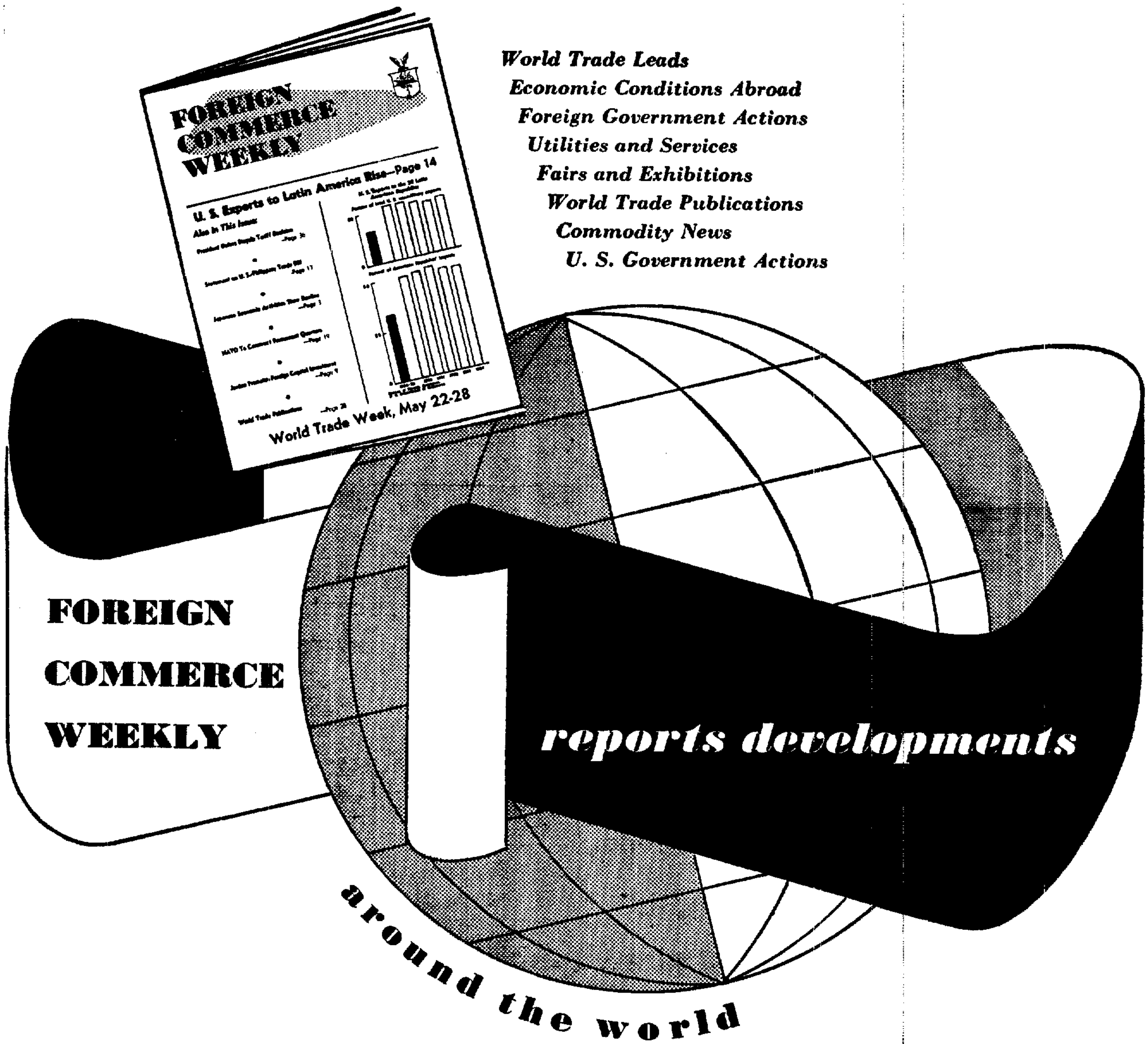

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